

America's Struggling Lower Half

Lane Kenworthy

March 2012

Inequality and rising living standards

One of the chief consequences of rising income inequality may be slower growth of living standards for those in the bottom half

Two questions

How much have living standards improved for America's lower-half households?

What can the experiences of other rich countries tell us about our possibilities and options?

How should we measure living standards?

Both income and other indicators of "material well-being" should be used

But due to data limitations, income is our best guide for assessing over-time developments

Has the 2008ff crisis changed everything?

Maybe, but we won't know for a while

I focus on 1979-2007

Summary of what I'll say

Incomes in America's lower half have increased very slowly

This is due to little or no increase in net government transfers, in employment, and in wages

What can be done?

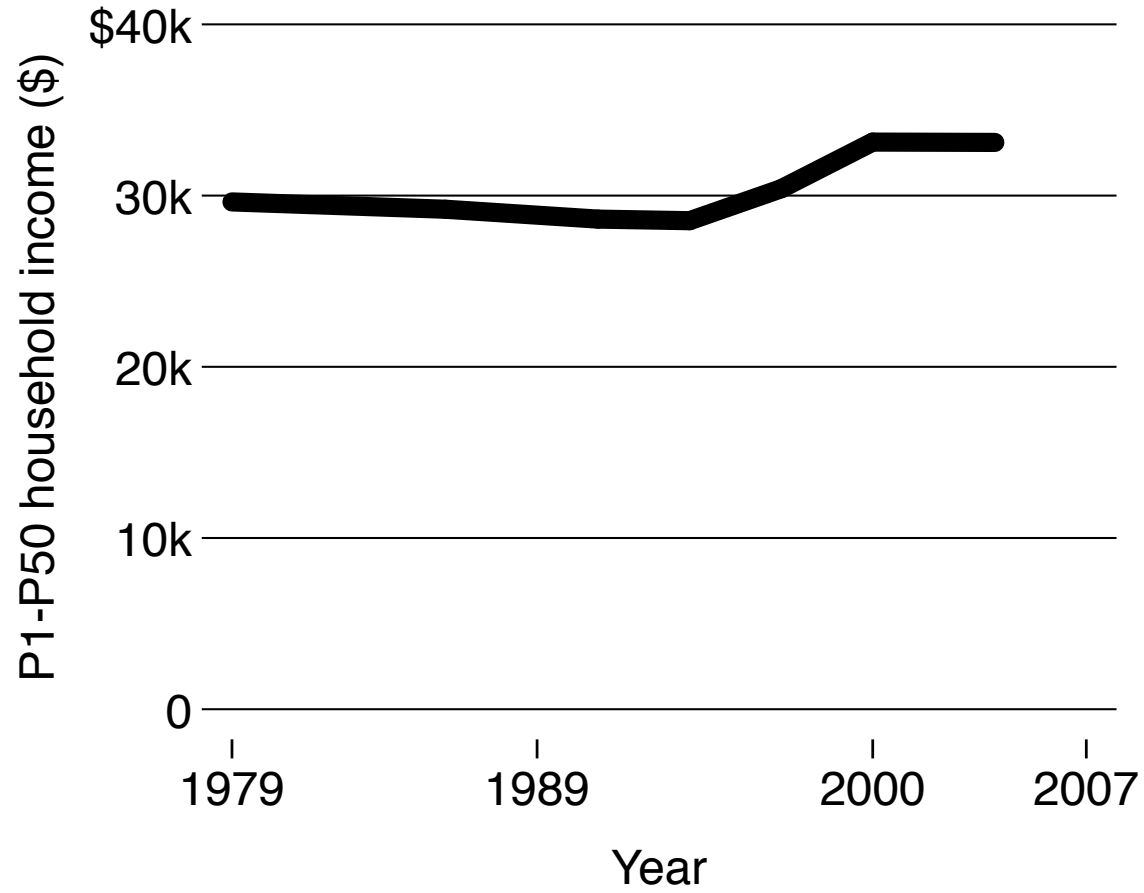
We can make progress on employment, but there's a limit

I'm very skeptical about wages

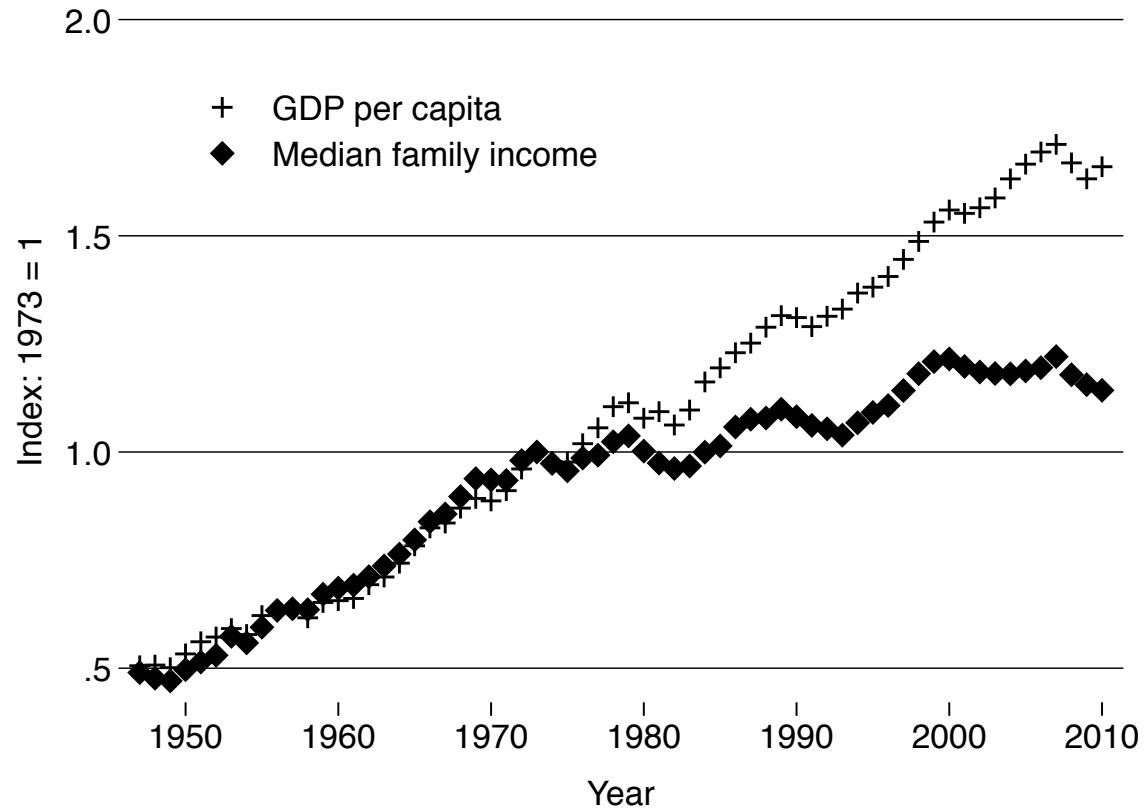
Over the long run, we may need a government subsidy to substitute for wages

How much have incomes improved for America's lower-half households?

Very little



Not because economic growth has been slow



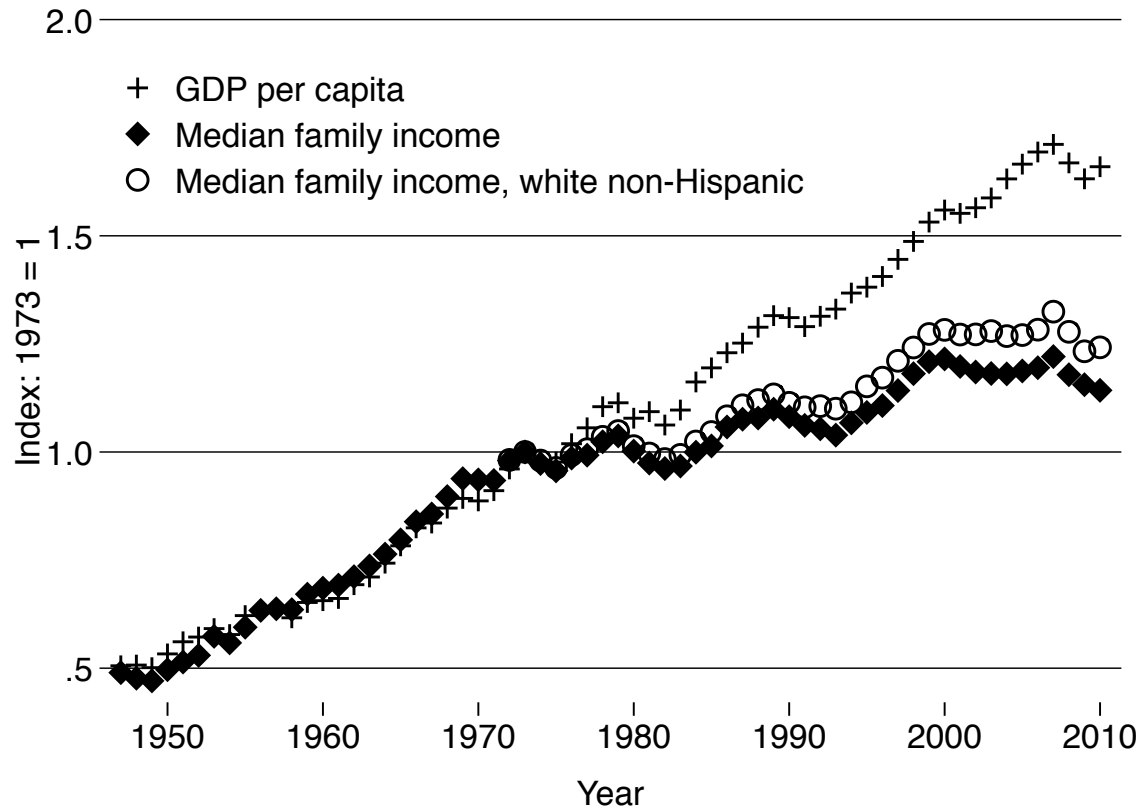
Not as bad as it looks?

Due to heightened immigration?

Is it because the flood of low-skilled immigrants pulls down the averages for those in the bottom half?

If so, maybe we shouldn't fret, because most of those immigrants have experienced a big improvement in income

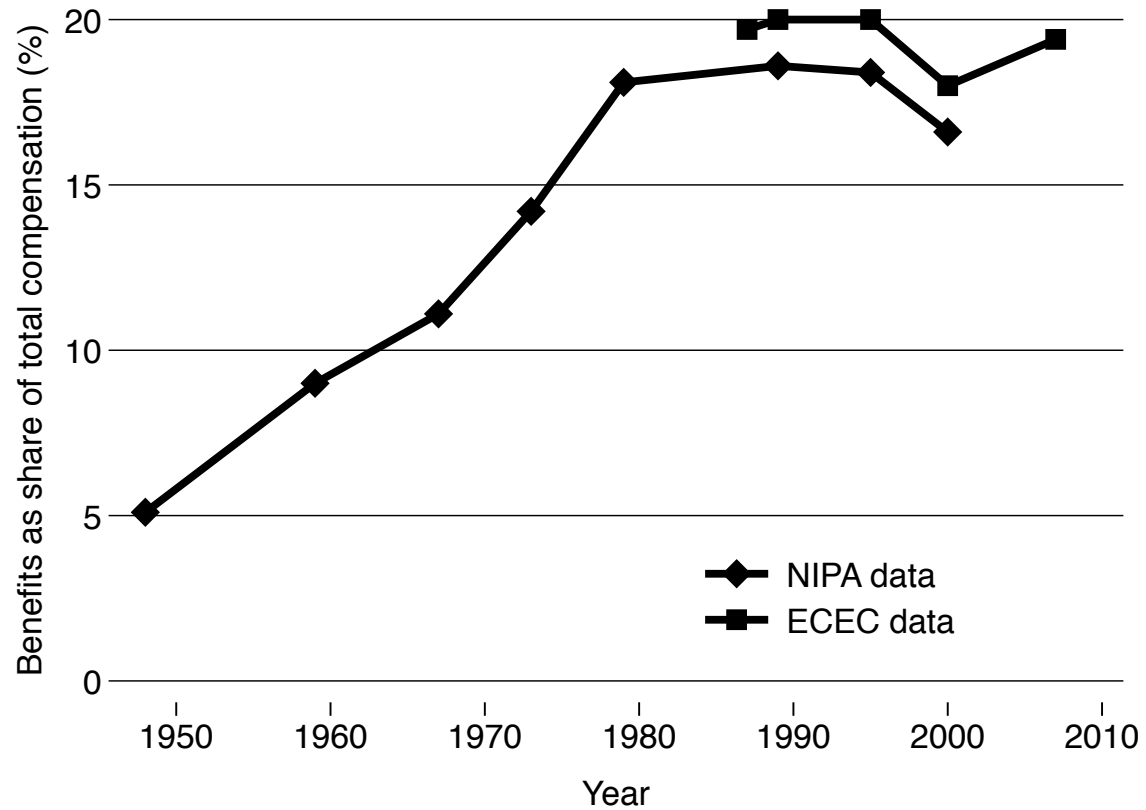
Due to heightened immigration?



Offset by growth of employer benefits?

Is it because employers have been paying a lot more toward benefits such as retirement and health insurance, leaving less for wages?

Offset by growth of employer benefits?



Offset by access to credit?

In the 1990s and 2000s, borrowing helped to substitute for rising wages and household incomes

With home values appreciating, middle-class families could take on more and more debt in order to fund rising consumption

And subprime loans gave low-income families access to mortgage loans

Offset by access to credit?

But that didn't, and arguably couldn't, last

Offset by new gadgets?

Living standards are enhanced by new and better medical technology, personal computers, cell phones, the internet, MP3 players, e-readers, and so on

Offset by new gadgets?

But it isn't clear that these innovations came any more quickly than in earlier decades, when incomes were growing rapidly

Nor are they enough: iPhones are great, but owning one won't help pay a mortgage or college tuition

Offset by mobility over the life course?

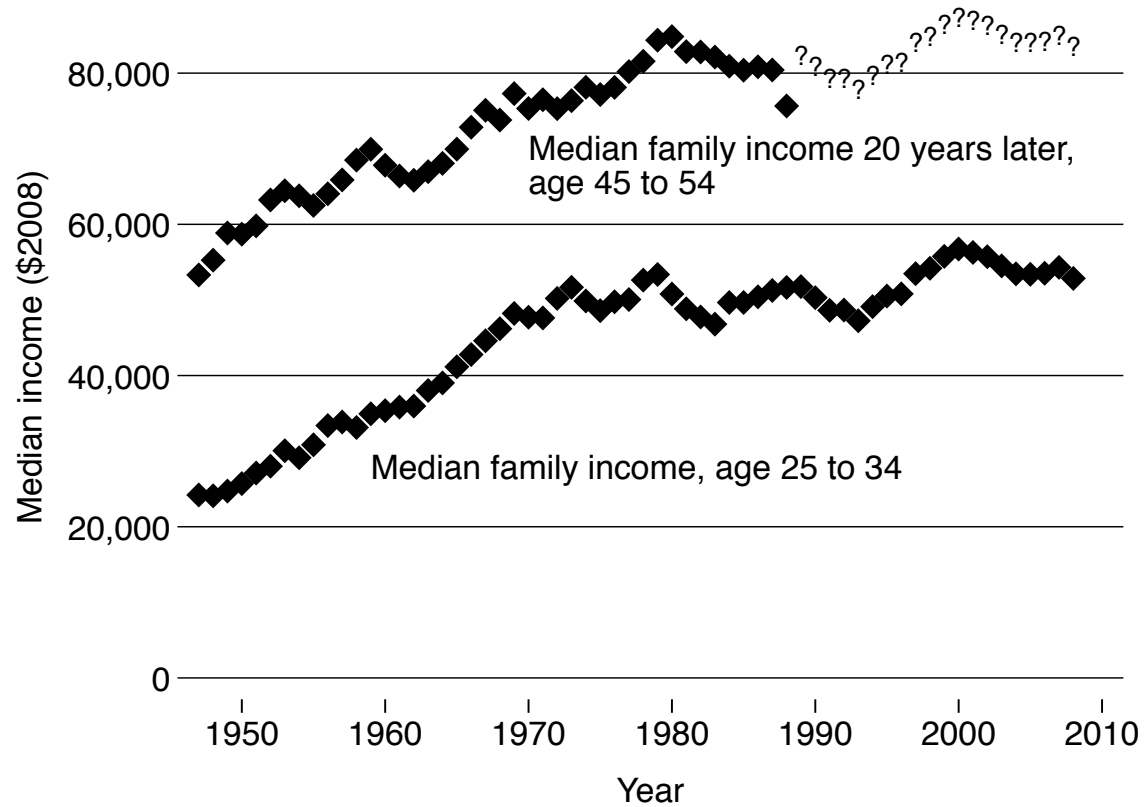
These data are repeated cross-sectional snapshots

They miss the fact that household income tends to rise during the life course

Offset by mobility over the life course?

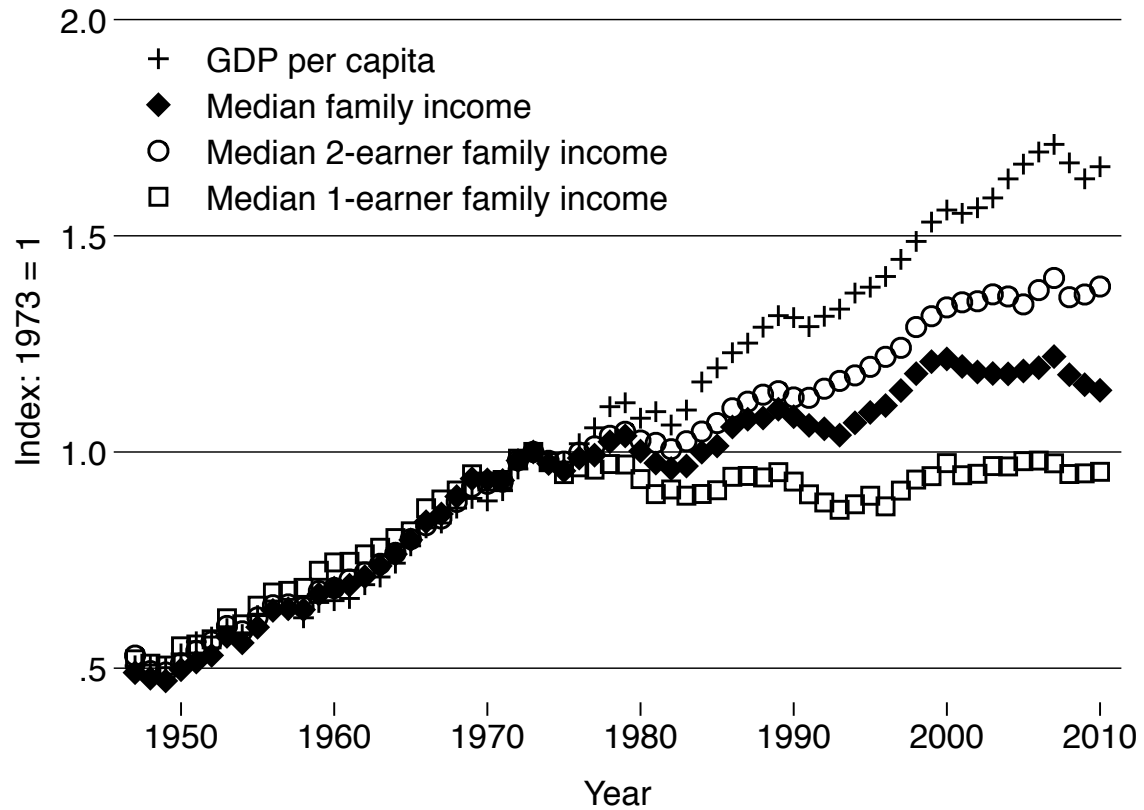
Yet the degree to which households start and finish ahead of previous generations has stopped increasing

Offset by mobility over the life course?

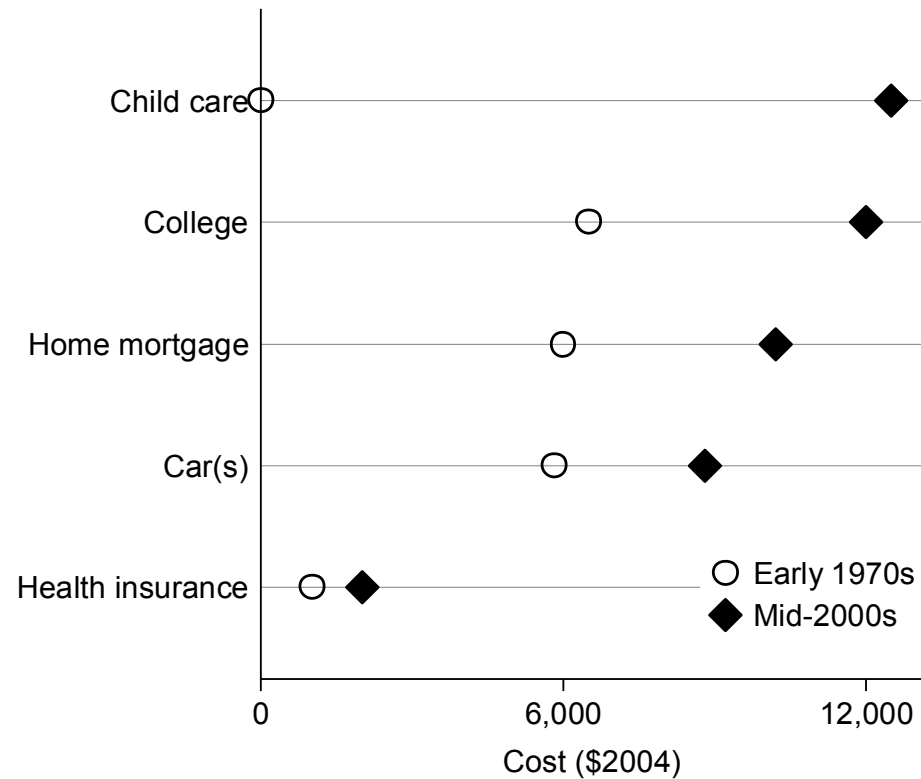


Worse than it looks?

Income growth now requires two earners



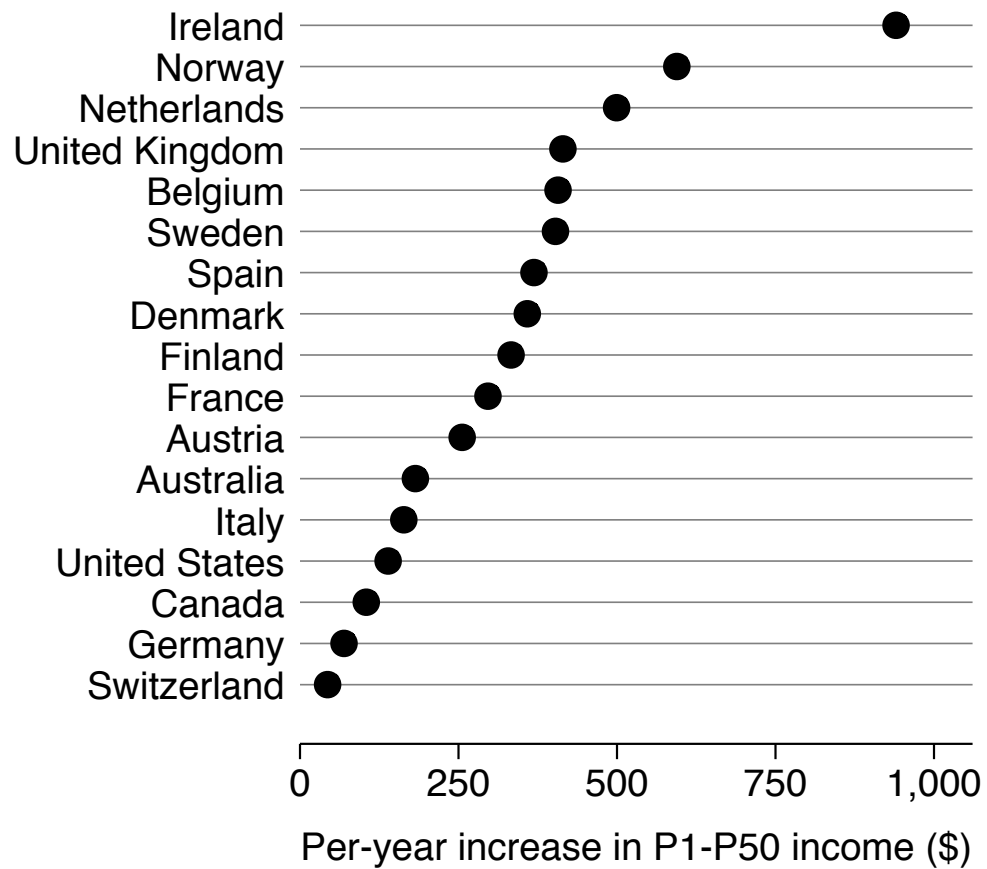
Costs of some big middle-class expenses have risen faster than inflation



Total costs: \$19,300 in the early 1970s, \$45,500 in the mid-2000s. Early 1970s: four-person family with one employed adult, one stay-at-home adult, and two preschool-age children. Mid-2000s: four-person family with two employed adults and two preschool-age children.

**Where and why have
lower-half incomes
increased?**

Income growth in lower-half households

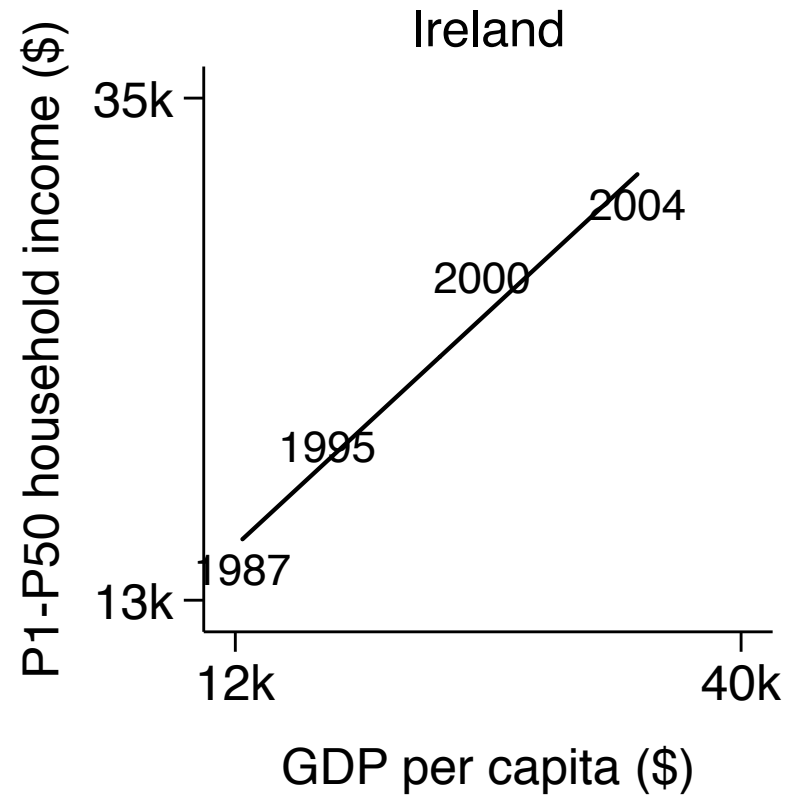


What accounts for the cross-country variation in income growth in lower-half households?

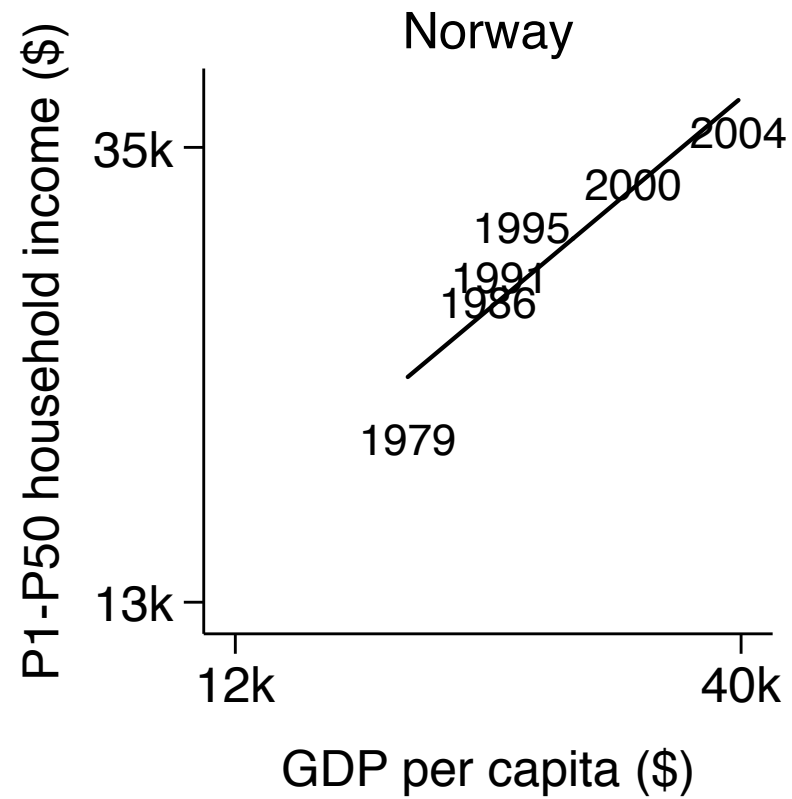
The variation across the countries owes partly to differences in the amount of economic growth

But if we exclude Ireland and Norway (special cases), about two-thirds of the variation stems from the degree to which economic growth reaches lower-half households

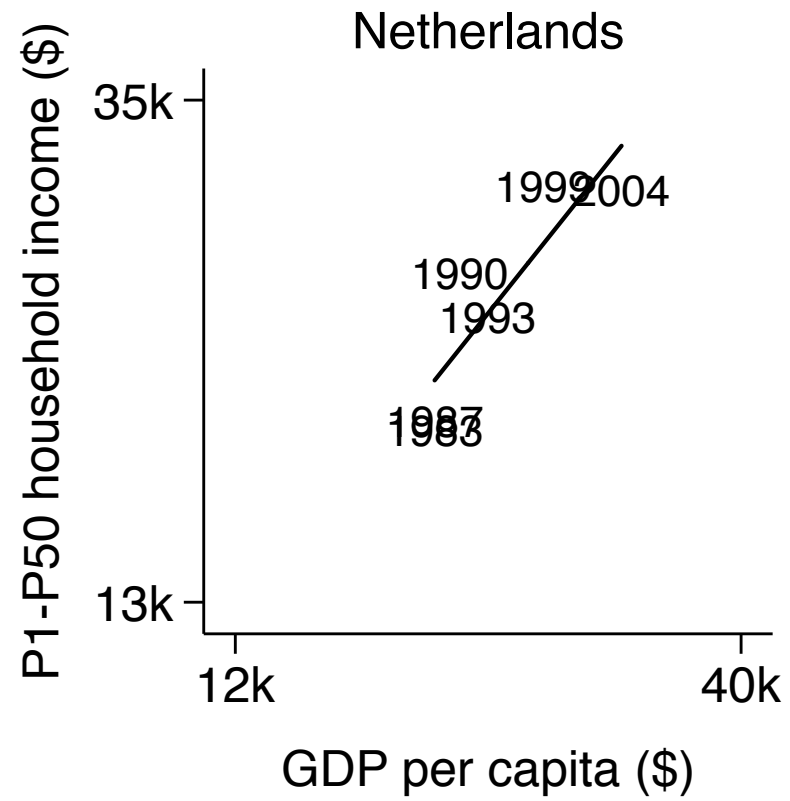
1. Ireland



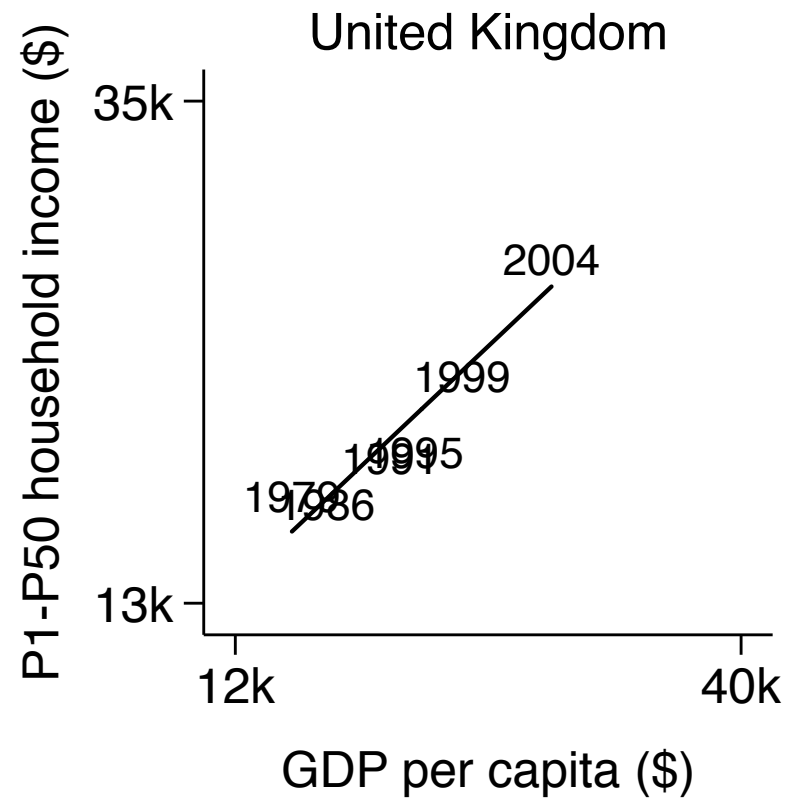
2. Norway



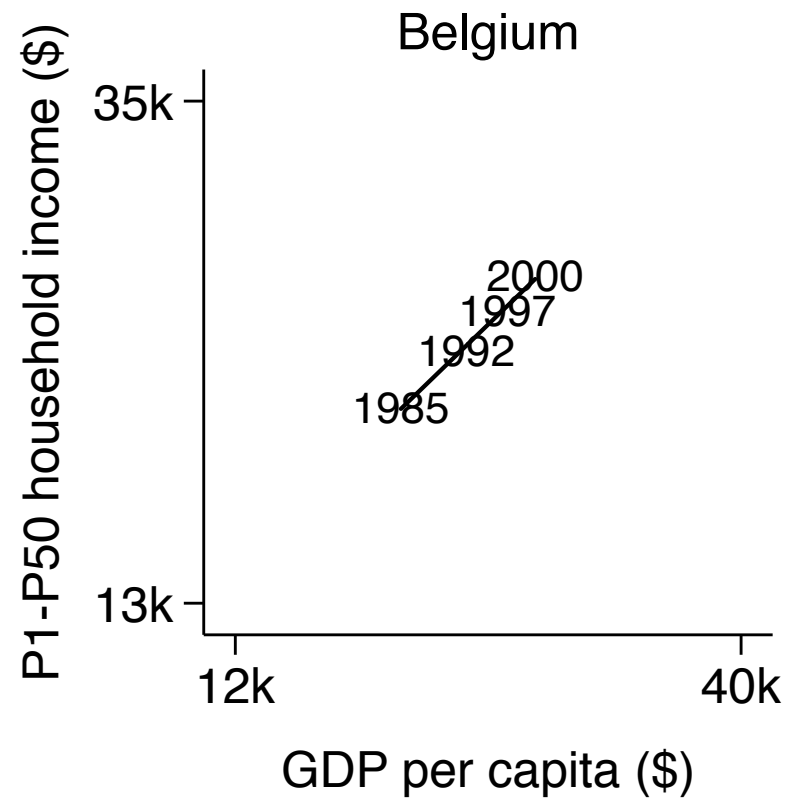
3. Netherlands



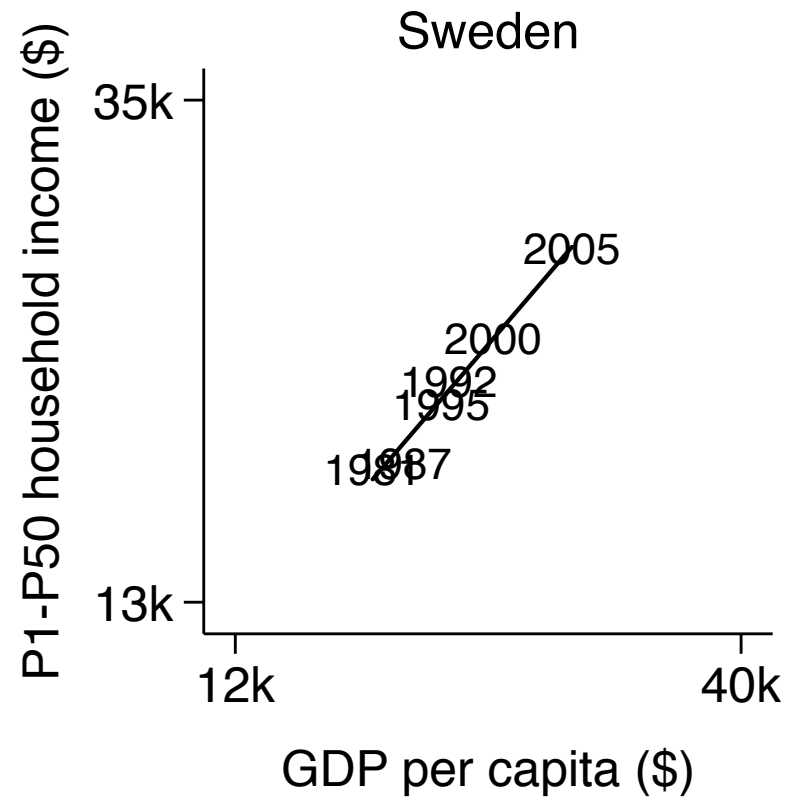
4. United Kingdom



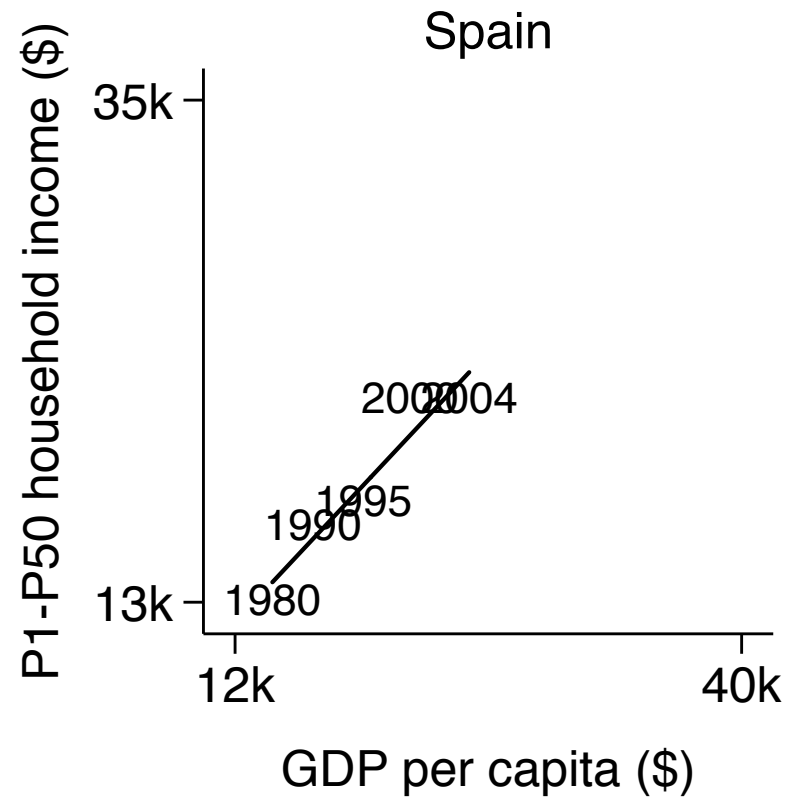
5. Belgium



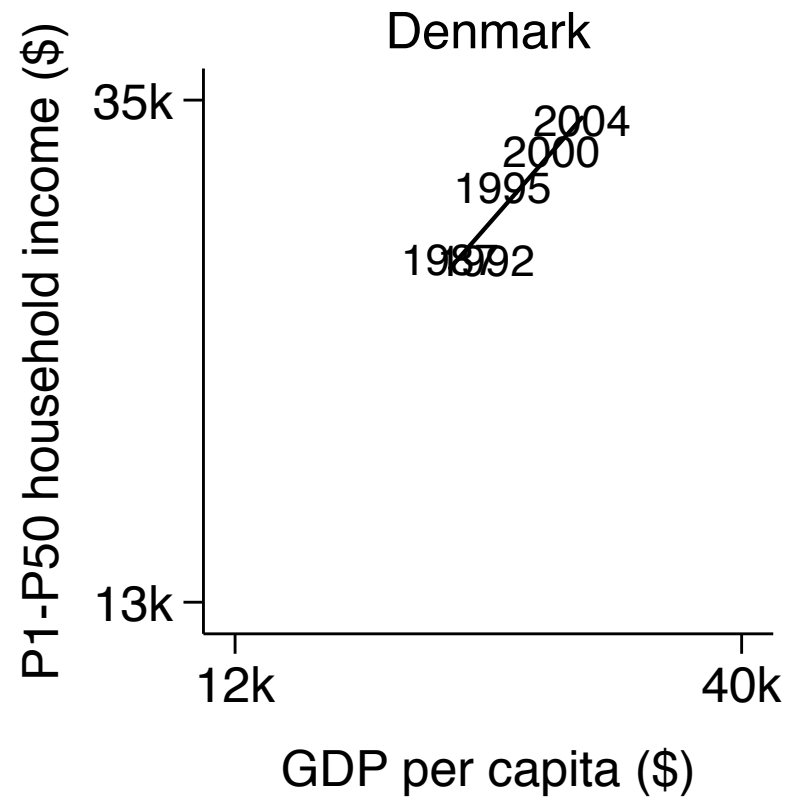
6. Sweden



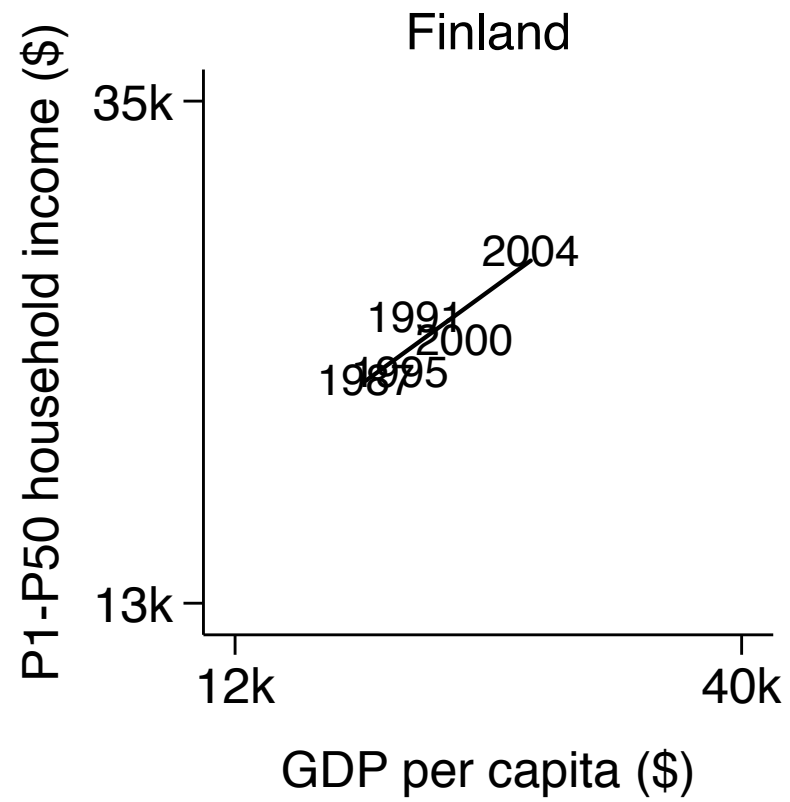
7. Spain



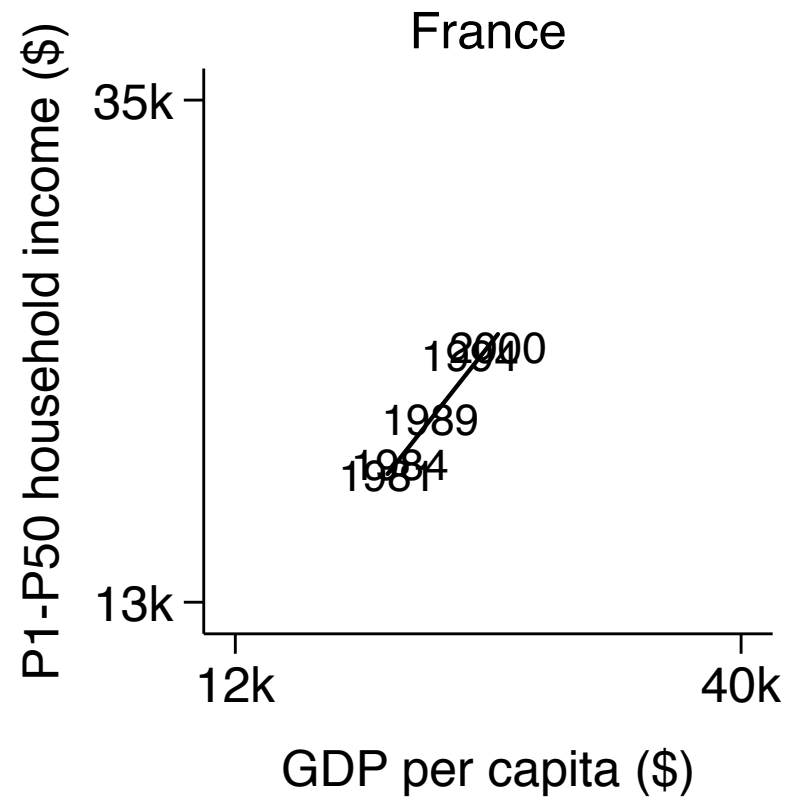
8. Denmark



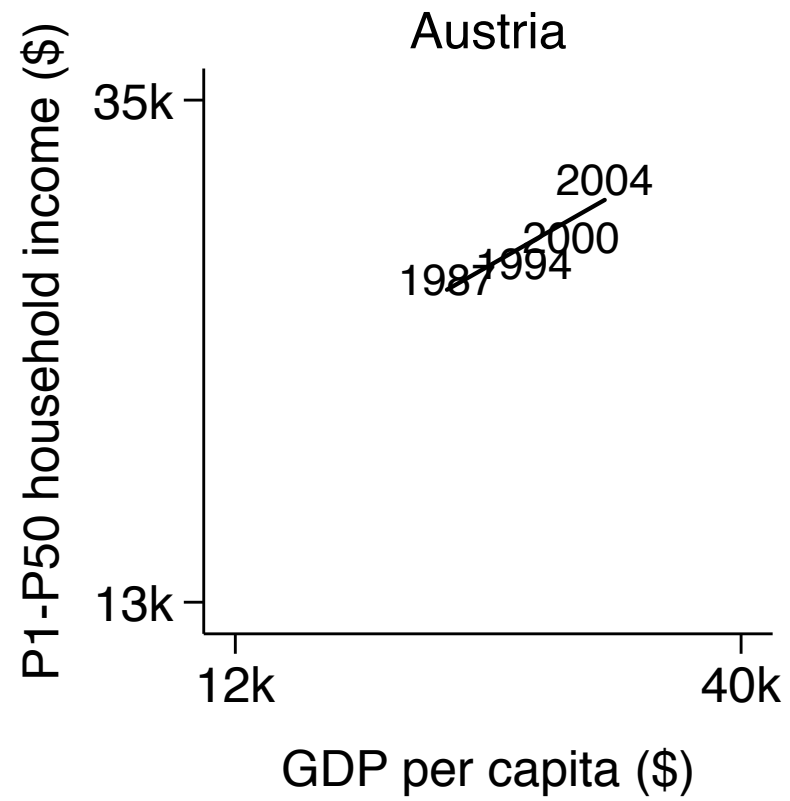
9. Finland



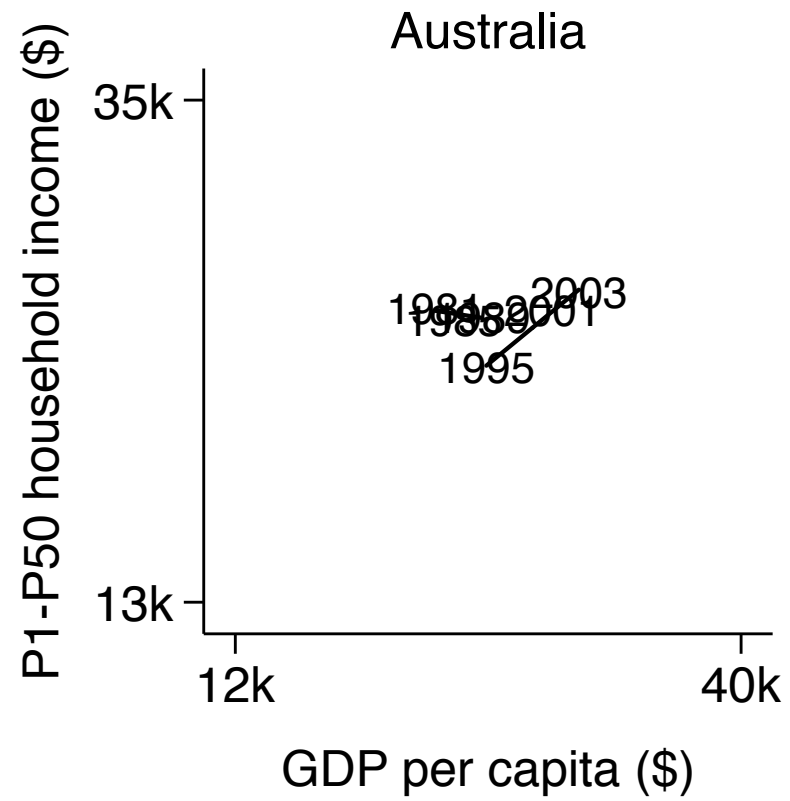
10. France



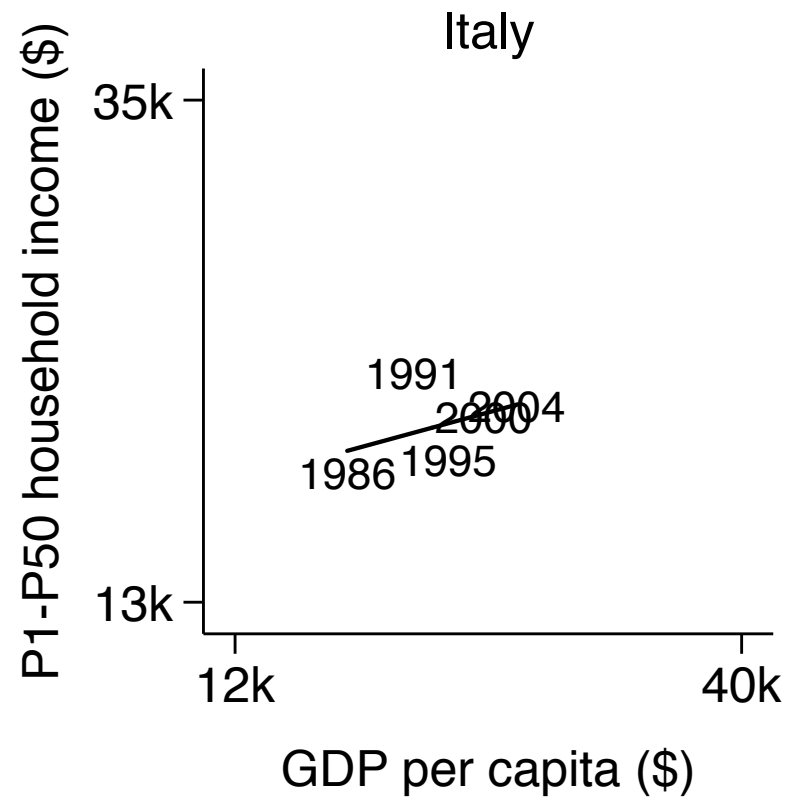
11. Austria



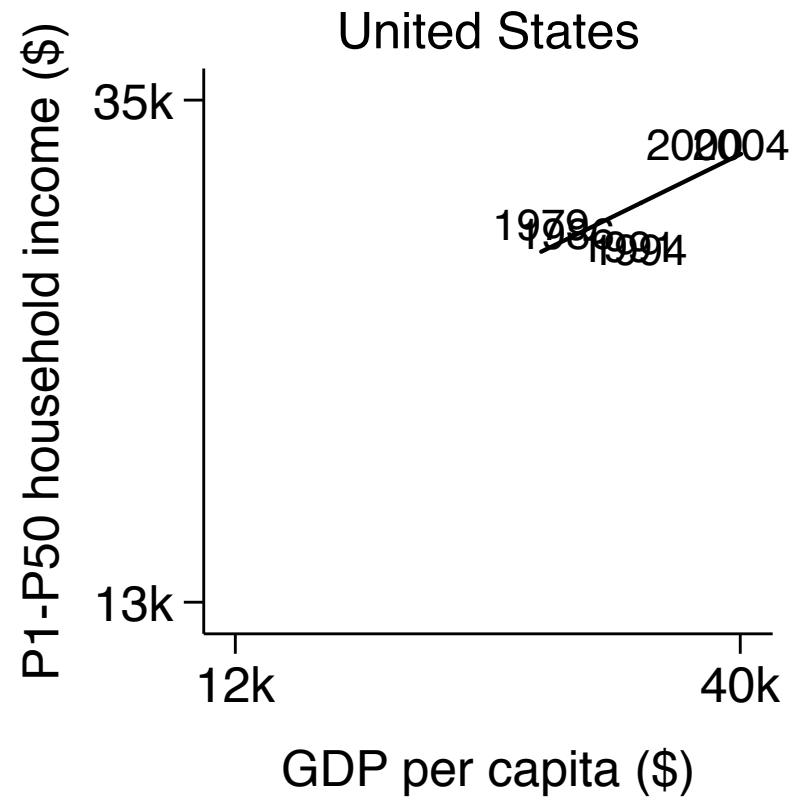
12. Australia



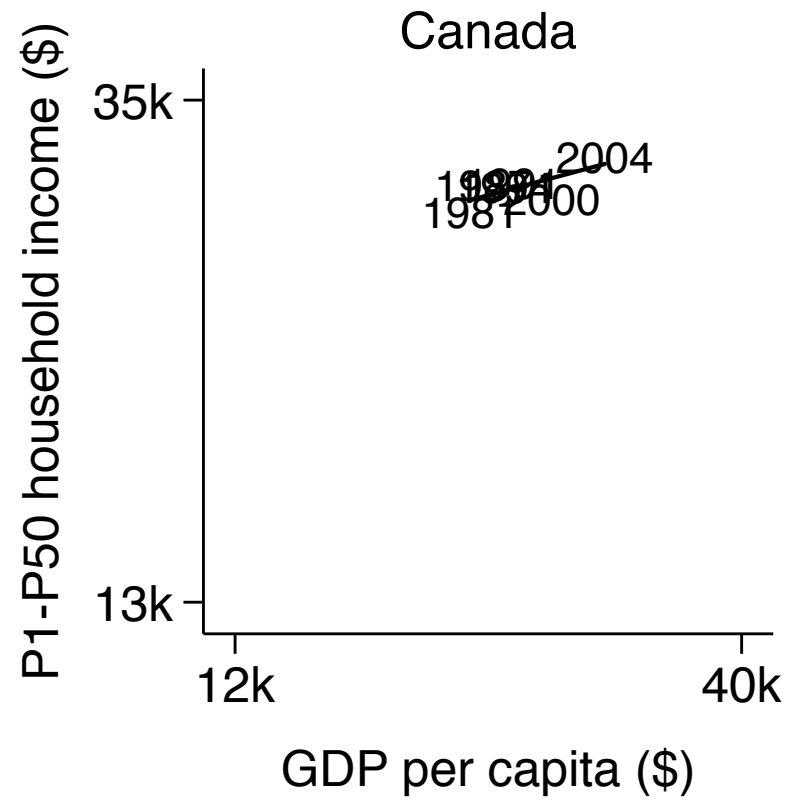
13. Italy



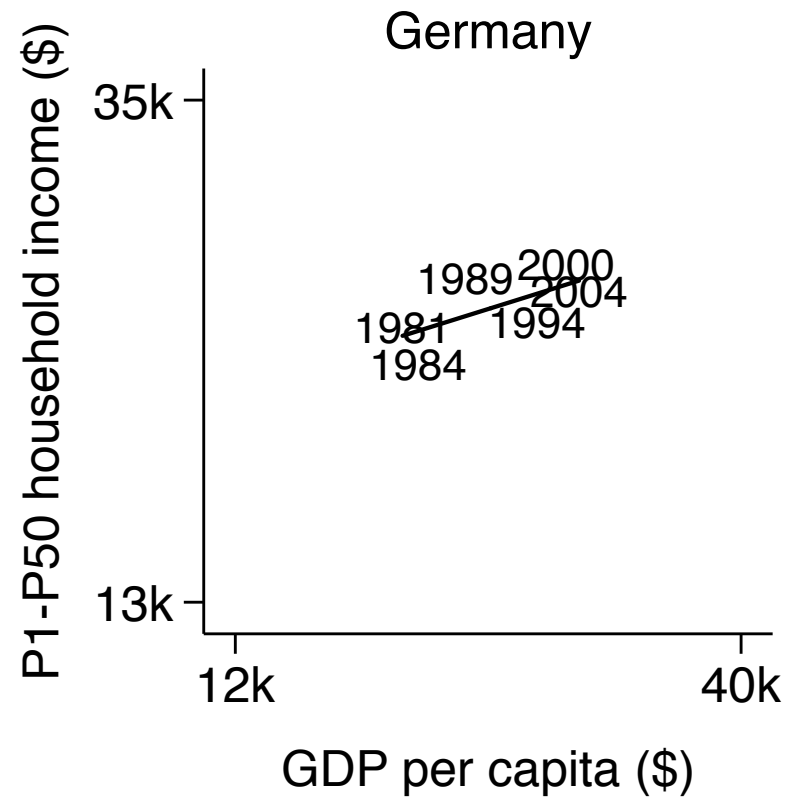
14. United States



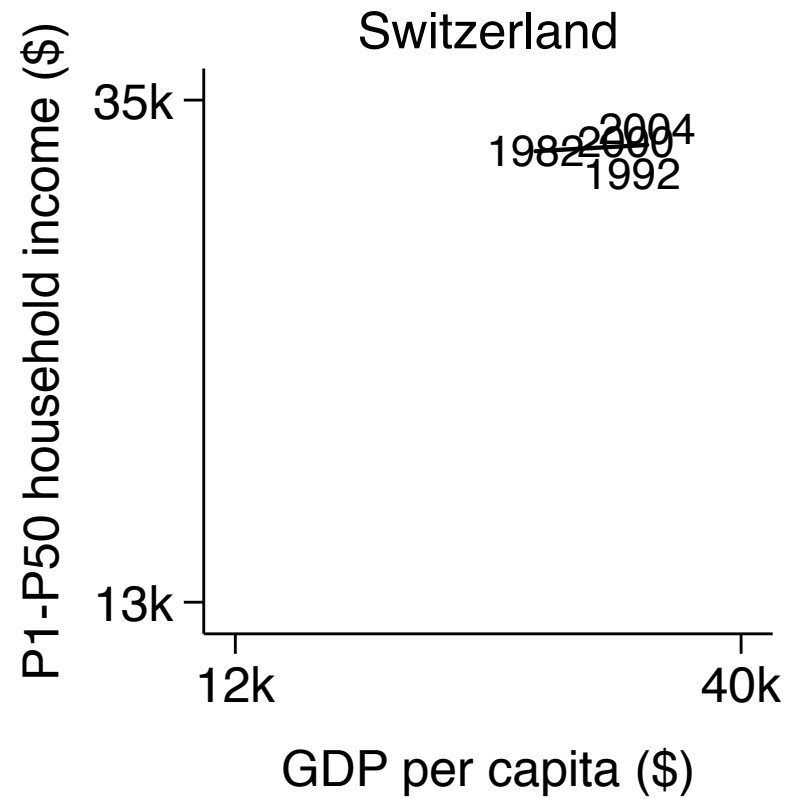
15. Canada



16. Germany



17. Switzerland



What accounts for the cross-country variation in economic growth's payoff?

What accounts for the cross-country variation in the degree to which economic growth has boosted incomes for households in the lower half?

What accounts for the cross-country variation in economic growth's payoff?

To get rising household incomes, we need increases in

Earnings

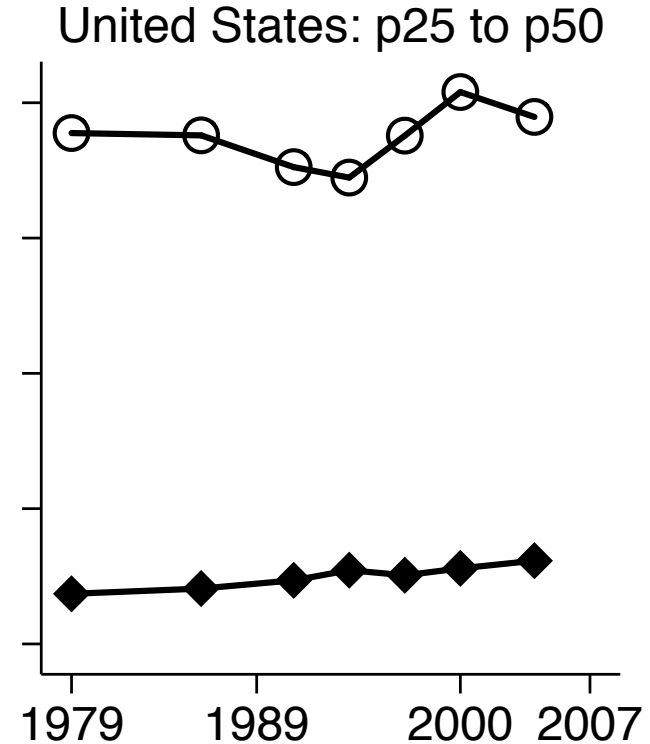
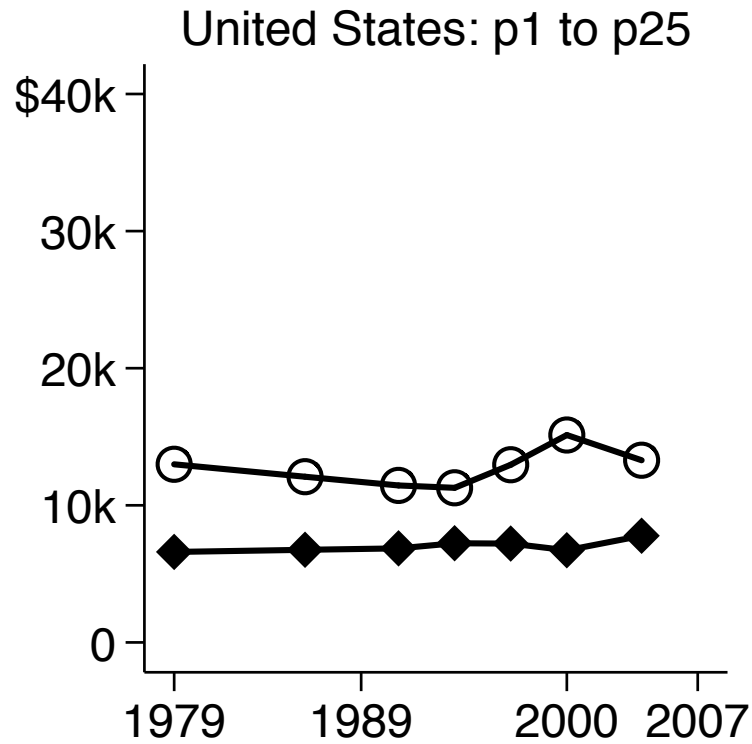
and/or

Net government transfers (transfers minus taxes)

For 12 of these 17 countries, it's possible to separate earnings from net government transfers

I also separate bottom-quartile (p1-p25) households from lower-middle-quartile (p25-p50) households

14. United States



○ earnings ◆ net government transfers

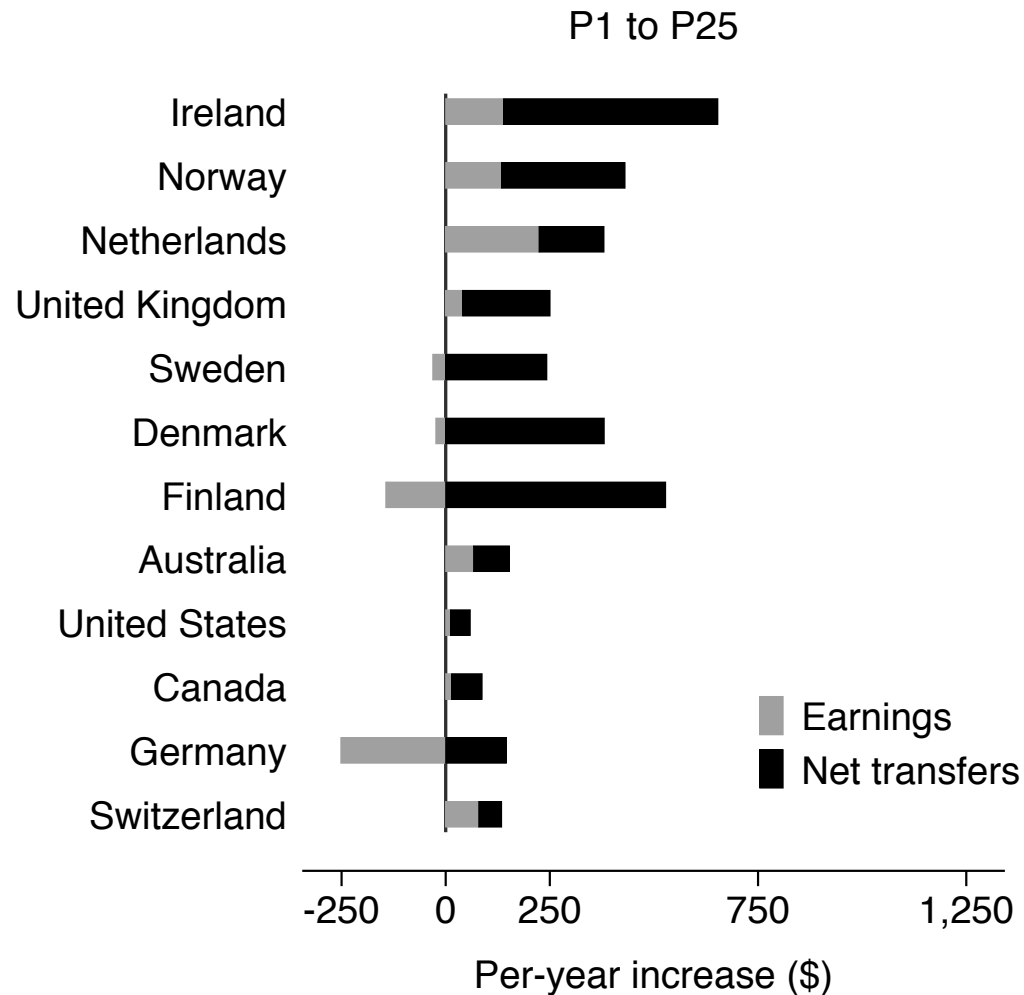
What accounts for the cross-country variation in economic growth's payoff?

The keys to success have been

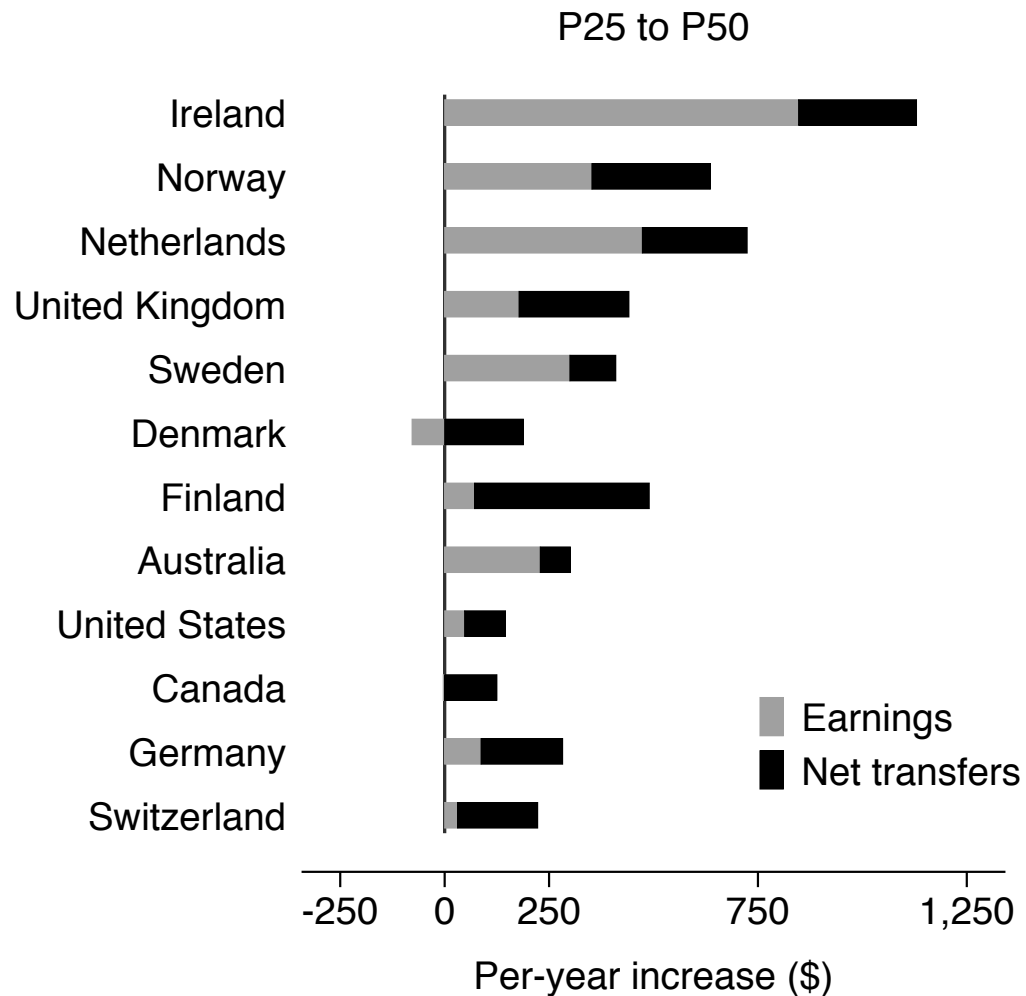
Bottom-quartile households: government transfers

Lower-middle-quartile households: earnings and government transfers

What accounts for the cross-country variation in economic growth's payoff?



What accounts for the cross-country variation in economic growth's payoff?



**What can be done in the
United States?**

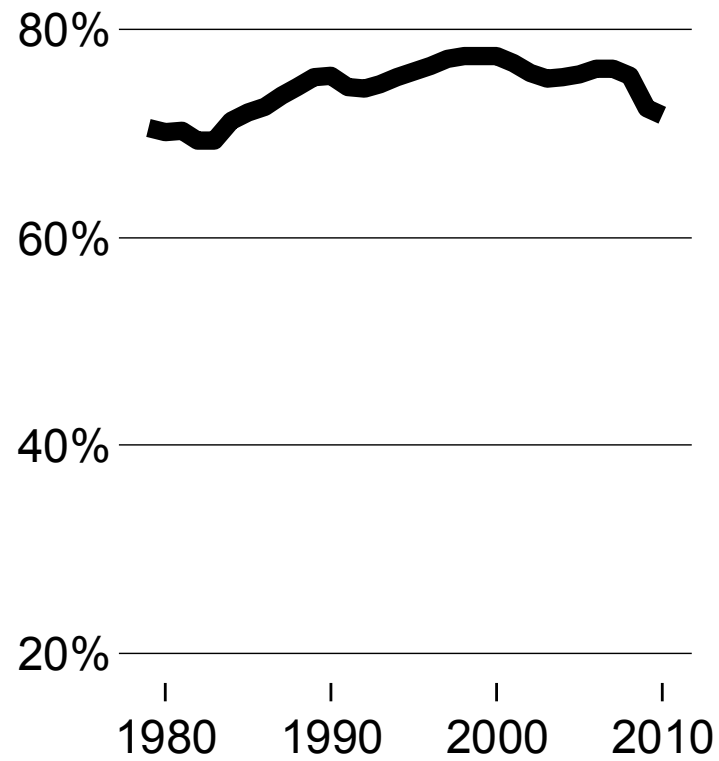
Employment?

We've pinned our hopes during the past generation on an employment solution

Employment growth has helped to boost household incomes, but it hasn't done enough

And the employment stagnation in 2000-07 (*before* the 2008 crash) suggests reason for pessimism going forward

Employment?

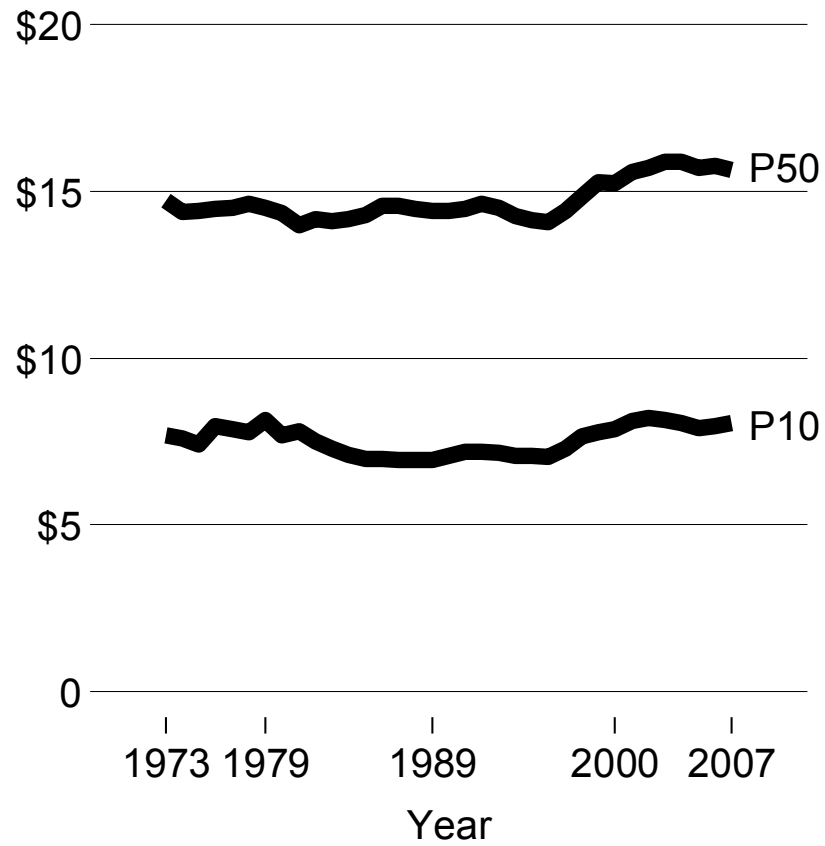


Employed persons as a share of the population, age 25-64

Wages?

Nor have we gotten wage growth

Wages?



Inflation-adjusted hourly wage for full-time year-round employees

Wages?

I'm skeptical that wage growth will return

In the early post-WW2 decades it was a product of

- Limited competition for firms

- Little pressure from shareholders to maximize short-run profits

- Pressure from unions (or threat of unions) to pass a healthy share of profit growths on to employees

These institutional features of the American economy are gone, and probably not coming back

Wages?

Plus, there are new obstacles to wage growth

Computerization

Stagnant educational attainment

Shift from manufacturing to services

Rise in less-skilled immigration

Greater use of "pay for performance"

Declining real minimum wage

The left's common solutions

"Full employment" (low unemployment)

Unions

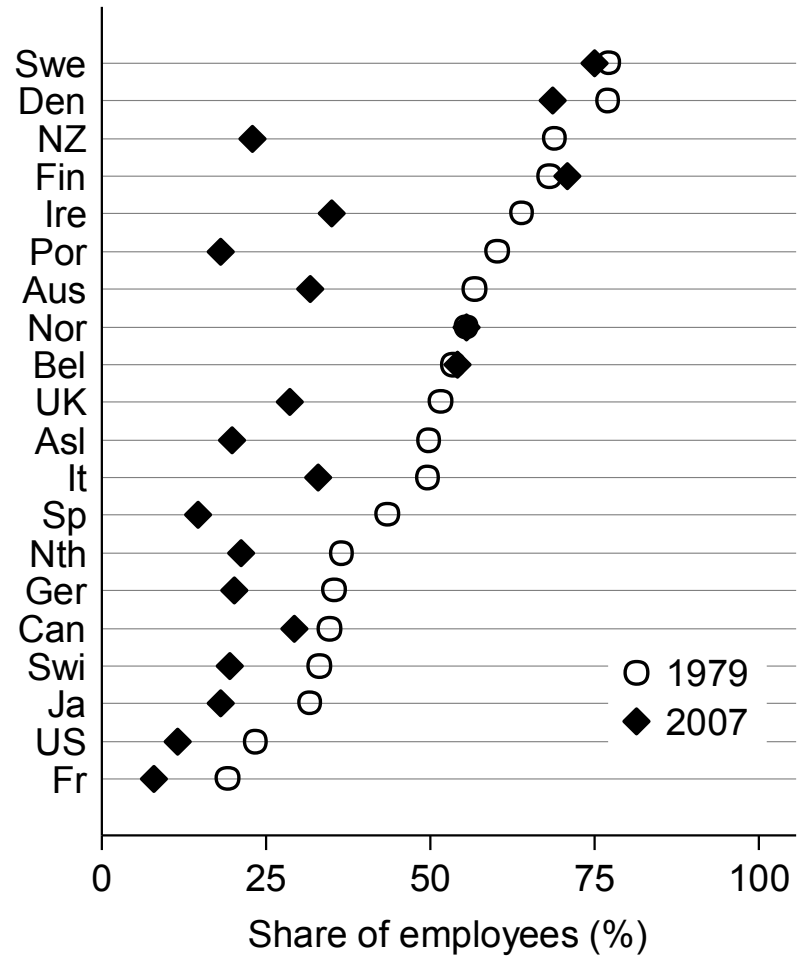
A higher statutory minimum wage

Full employment?

Low unemployment does seem to have been key to wage growth in the late 1990s

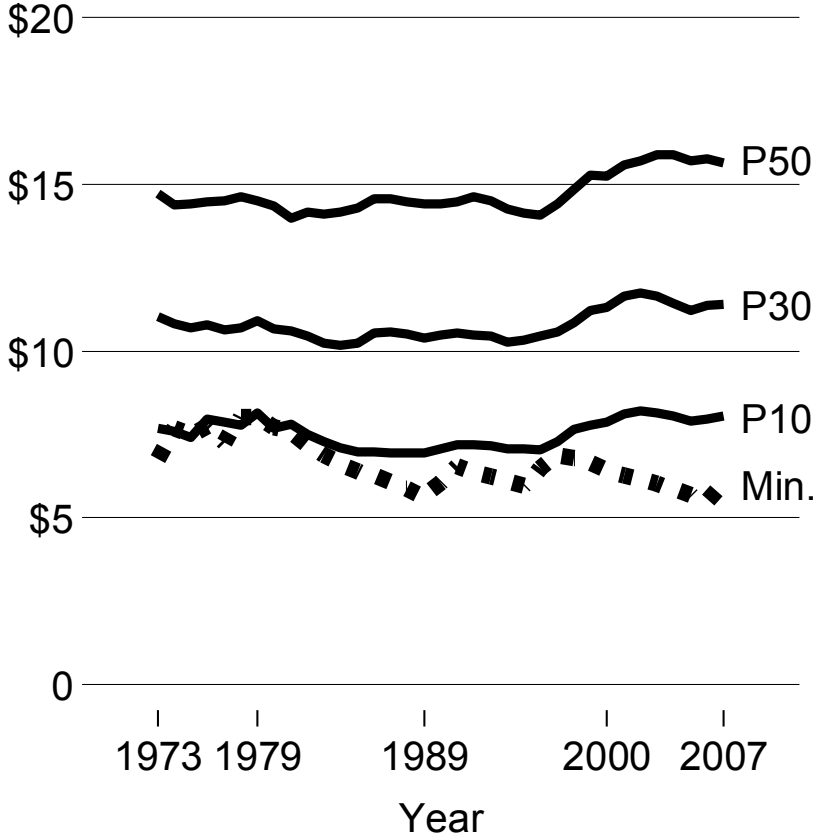
But the Federal Reserve probably won't allow that to happen again

Unions?



Unionization rates in twenty rich countries, 1979 and 2007

The minimum wage?



Inflation-adjusted statutory minimum wage, P10 wage, P30 wage, and P50 wage

My suggestions

Education, especially pre-K, to boost living standards directly and facilitate employment

Other public goods and services: health care, infrastructure, transportation, public spaces, etc.

Minimum wage: indexed to prices

Earned Income Tax Credit (EITC): expanded into the middle class and indexed to average wages